

MAY 21 1992

Employer Identification Number: [REDACTED]  
Form: 1120  
Tax Years: All years  
Key District Office: Los Angeles

Dear Applicant:

This is a final adverse ruling as to your exempt status under section 501(c)(3) of the Internal Revenue Code.

This ruling is made for the following reasons: You have failed to establish that you are operated exclusively for exempt purposes under section 501(c)(3). You have failed to establish that you are not operated for a substantial nonexempt purpose and that you do not serve private interests more than incidently.

Contributions to your organization are not deductible under section 170 of the Code.

You are required to file federal income tax returns on the above form. Based on the financial information you furnished, it appears that returns should be filed for the tax years shown above. You should file these returns with your key District Director for exempt organization matters within 30 days from the date of this letter, unless a request for an extension of time is granted. Returns for later tax years should be filed with the appropriate service center as indicated in the instructions for those returns.

If you decide to contest this ruling under the declaratory judgment provisions of section 7428 of the Code, you must initiate a suit in the United States Tax Court, the United States Claims Court, or the District Court of the United States for the District of Columbia before the 91st day after the date that this ruling was mailed to you. Contact the clerk of the appropriate court for rules for initiating suits for declaratory judgment. Processing of income tax returns and assessment of any taxes due will not be delayed because a declaratory judgment suit has been filed under section 7428.

[REDACTED]

In accordance with section 6104(c) of the Code, the appropriate State officials will be notified of this action.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown above.

Sincerely,

[REDACTED]  
Director, Exempt Organizations  
Technical Division

cc: DD, Los Angeles  
Attn: EO Group

cc: w/Form 5998  
State Officials of [REDACTED]

cc: [REDACTED]

[REDACTED]

[REDACTED]

JUL 10 1990

Employer Identification Number: [REDACTED]  
Key District Office: Los Angeles

Dear Applicant:

We have completed our consideration of your application for recognition of exemption from federal income tax. We have concluded that you are not exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code. The reasons for our conclusions are explained below.

The information submitted indicates that you were organized as a nonprofit corporation under the laws of the State of [REDACTED] on [REDACTED].

You state in your Articles of Incorporation that your specific purpose is "to provide charitable services, activities and gifts to [REDACTED] at [REDACTED] and other Nonprofit Veteran's Organizations in [REDACTED]."

You indicate in your application for exemption that you generate funds through telephone solicitations in order to provide outside activities for hospital confined veterans. These activities include baseball and football games, trips to recreational facilities and golf tournaments.

You also indicate that your funds are raised under fictitious business names and that you donate a percentage of these receipts to charitable organizations operated for the benefit of veterans, abused children, blind children, battered women, and animal protection. Your statement of income and expenses reflects the following contributions to charities:

	Gross Receipts	Contributions to Charity	Percent to Charity
[REDACTED]	\$ [REDACTED]	\$ [REDACTED]	10%
[REDACTED]	[REDACTED]	[REDACTED]	9%
[REDACTED]	[REDACTED]	[REDACTED]	7%
Total	\$ [REDACTED]	\$ [REDACTED]	9%

[REDACTED]

Your fund raising activity is performed by telephone solicitors, managers and assistant managers of telephone solicitors, and drivers who will go to the premises of contributors to collect the donation. Individuals working in these positions are compensated based on a percentage of total contributions received in the following amounts:

Telephone Solicitor	35%
Manager of Telephone Solicitors	10%
Assistant Manager of Telephone Solicitors	5%
Driver	10%

Total Percentage of Contributions to Commissions 60%

You attract telephone solicitors and drivers through advertisements placed in local newspapers. The advertisements placed to attract solicitors indicate that no selling is required to earn commissions and that cash is paid daily. Advertisements soliciting drivers indicate that cash is paid daily and that they must have their own vehicle and insurance.

Telephone solicitors enter into an Independent Contractor Agreement with you whereby you agree that the solicitor is free from your control in respect to the details of the soliciting work such as where and when the solicitor works. You do, however, reserve the right to maintain quality control and to provide instructions concerning the work performed. You presently employ ten solicitors who are independent contractors.

Standardized scripts such as the following [REDACTED] phone script are used by solicitors to raise funds.

"Hello! May I speak to Mr. or Mrs. \_\_\_\_\_?"

Hi! Mr./Mrs. \_\_\_\_\_ my name is \_\_\_\_\_, and I'm calling from the [REDACTED] here in the valley.

We are the organization that is currently working with the battered and abused children in the area that have been put in shelters.

What we do is raise funds to provide counseling for the children and their parents - as well as psychological rehabilitation for the kids.

We also get the kids out of the shelters once a month or so, on sponsored activities with their counselors, to [REDACTED], [REDACTED], and thing of that nature.

Since there are [REDACTED] children a year in the [REDACTED]

[REDACTED] area that are severely abused either physically, mentally, or sexually and, unfortunately, usually by their parents, we need all the help we can get -- to get these kids the counselling they need before they end up abusing their own kids.

We are a non-profit public benefit organization, we were hoping you could help us, and we only ask once a year, with a tax deductible donation to help sponsor some of these kids? Here is how you can help!

4 kids, \$140.00; 3 kids, \$105.00; 2 kids, \$70.00; 1 child, \$35.00

Close .....

Great, we have a driver in your area today who can stop by at your convenience and pick up your donation. He/she will have the proper I.D., a tax receipt and a letter of thanks for you.

Now what I need you to do is, get your checkbook and make the check out to: [REDACTED].

In the memo section of your check, put the tax I.D. Number [REDACTED]. That will allow you to deduct this donation one hundred percent.

Now for your own protection, you might want to turn the check over, and put "FOR DEPOSIT ONLY" on the back, that means the only thing that can be done with it is that it can be deposited or paid to [REDACTED] only.

Our driver can be out there for you anytime today or this evening, at your convenience, what time would be best for you?

Great, we'll be there. Thank you so much. Bye, Bye"

Section 501(c)(3) of the Code provides for exemption from federal income tax of organizations organized and operated exclusively for charitable, scientific, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a) of the Income Tax Regulations provides that an organization must be both organized and operated exclusively for one or more of the purposes specified in section 501(c)(3) of the Code.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more such exempt purposes specified in section 501(c)(3) of the Code, but will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

The presence of a single nonexempt purpose, if substantial in nature, will preclude exemption under section 501(c)(3) regardless of the number or importance of the organization's exempt purposes. See Better Business Bureau v. U.S., 326 U.S. 279 (1945).

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to qualify under section 501(c)(3), an organization must establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creators or the creator's family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations states that the term "charitable" is used in section 501(c)(3) in its generally accepted legal sense. The term includes: relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening the burdens of government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice or discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency.

Section 1.501(c)(3)-1(e)(1) of the regulations provides that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the activities which are in furtherance of one or more exempt purposes.

Revenue Ruling 64-182, 1964-1 C.B. (Part 1) 186, provides that

an organization which derives all of its income from a commercial enterprise is nevertheless entitled to exemption under section 501(c)(3) of the Code where it is shown to be carrying on, through contributions and grants to other charitable organizations, a charitable program commensurate in scope with its financial resources.

In Revenue Ruling 69-383, 1969-2 C.B. 113, the Service described a compensation agreement between an exempt hospital and a hospital based radiologist. Payments were on the basis of a fixed percentage of the departmental income. The Service concluded that the compensation agreement did not jeopardize exemption because the hospital paid the radiologist a fixed percentage of the department's gross billings to patients for services rendered. The amount received by the radiologist under the contract was for services rendered and was not excessive when compared to the amounts received by radiologists having similar responsibilities and handling a comparable patient volume at other similar hospitals. However, the Service added that under certain circumstances, the use of a method of compensation based upon a percentage of income can constitute inurement. For example, if the compensation agreement transforms the principal activity of the organization into a joint venture between private individuals and the organization, or if the arrangement is merely a device for distribution of profits to persons in control, the organization's exemption under section 501(c)(3) of the Code would be destroyed. See Lorain Avenue Clinic v. Commissioner, 31 T.C. 141 (1958).

Revenue Ruling 71-447, 1971-2 C.B. 230, provides that charitable trusts (and by implication charitable organizations, regardless of their form) are subject to the requirement that their purpose may not be illegal or contrary to public policy. Restatement (Second) of Trusts, Section 377, Comment c (1959).

In Help the Children v. Commissioner of Internal Revenue, 28 T.C. 1128 (1957), the court held that an organization engaged in fund-raising activities through the operation of bingo games and whose actual charitable functions consisted of contributions to charitable institutions of insubstantial amounts when compared to its gross receipts from the operation of bingo games, does not qualify for exemption under section 501(c)(3) of the Code.

In Universal Church of Jesus Christ, Inc. v. Commissioner, T.C. Memo 1988-65 (1988), the Tax Court agreed with the Service that revocation of the organization's exemption under section 501(c)(3) was appropriate. In its decision the court pointed out that the commercial activity was so substantial that the organization's exempt activities were no more than insignificant. In reaching this conclusion the court stated that if a nonexempt purpose is not an expressed goal, courts will look at the manner

[REDACTED]

in which the organization's activities are conducted, inferring an end from the chosen means. Factors to which the courts will look are the manner in which activities are conducted, the commercial nature of such activities, and the existence and amounts of annual or cumulative profits.

In Founding Church of Scientology v. U.S., 412 F.2d 1197 (1969), the court held, in part, that where the founder of a church was paid a salary based on a percentage of gross receipts, and also received fees, royalties, and commissions, the church was not entitled to exemption from federal income tax under section 501(c)(3) of the Code. The church's net earnings inured to the benefit of private individuals.

Based on the information submitted, we have concluded that you are not operated exclusively in furtherance of charitable or educational purposes within the meaning of section 501(c)(3) of the Code. Based on the fact that you engage in extensive telephone solicitation in a commercial manner and the fact that the amount of the gross receipts that you distribute to charities is not commensurate in scope with your financial resources, we conclude that you engage in substantially the same activities as other commercial fund raising organizations. See sections 1.501(c)(3)-1(c)(1) and 1.501(c)(3)-1(e)(1) of the regulations, the Better Business Bureau, Help the Children, and Universal Church of Jesus Christ, Inc. cases, and Rev. Rul. 64-182.

Moreover, it appears that your activities result in your providing certain private individuals, namely your managers, solicitors and drivers, with substantial impermissible private benefit. The commission compensation arrangements that you enter into with these individuals transforms the principal activity of your organization into a joint venture between these private individuals and your organization. See section 1.501(c)(3)-1(d)(1)(ii) of the regulations and Rev. Rul. 69-383.

Lastly, it appears that your use of fictitious names to solicit funds should be viewed as conduct contrary to public policy. See Rev. Rul. 71-447.

You are required to file federal income tax returns. Contributions to your organization are not deductible under section 170(c) of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement must be submitted within 30 days of the date of this letter and must be signed by one of your officers. You also have a right to a conference in this office after your statement is submitted. If



[REDACTED]

you want a conference, you must request it when you file your protest statement. If you are to be represented by someone who is not one of your officers, he/she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements.

If you do not protest this proposed ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the United States Tax Court, the United States Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key District Director. Thereafter, any questions about your federal income tax status should be addressed to that office. The appropriate State officials will be notified of this action in accordance with section 6104(c) of the Code.

When sending additional letters with respect to this case to the Internal Revenue Service, you will expedite their receipts by placing the following symbols on the envelope: E:EO:R:2-6, Room 6514. These symbols do not refer to your case but rather to its location.

Sincerely,

(Signed) [REDACTED]

[REDACTED]  
[REDACTED]  
Chief, Exempt Organizations  
Rulings Branch 2

cc: State Officials of [REDACTED]

cc: DD, Los Angeles  
Attn: EO Group

cc: [REDACTED]

[REDACTED]